

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE**

| | | |
|-------------------------------------|---|------------------------|
| IN THE MATTER OF THE APPLICATION OF |) | |
| SUEZ WATER DELAWARE INC. |) | |
| FOR A GENERAL INCREASE IN RATES |) | PSC DOCKET NO. 16-0163 |
| AND FOR A REVISION |) | |
| TO ITS GENERAL TARIFF |) | |
| (FILED FEBRUARY 5, 2016) |) | |

**EXCEPTIONS OF SUEZ WATER DELAWARE TO THE
SEPTEMBER 26, 2017 FINDINGS AND RECOMMENDATIONS
OF THE HEARING EXAMINER**

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Dated: October 18, 2017

INTRODUCTION

SUEZ Water Delaware, Inc. (“SWDE”) respectfully takes exception to paragraph 52 of the Hearing Examiner’s report (the “Report” attached hereto as Exhibit A) and to paragraph 4 of his proposed order No. 9117 for disposition of Phase II of this rate case proceeding. In Phase I of the proceeding, the Commission established new SWDE rates and tariff changes. (Order No. 9027, February 23, 2017). Phase II only concerns review of a Management and Services Agreement allocating the cost of shared services and resources provided by an entity in the SUEZ organization to SWDE, other SUEZ regulated water utility companies and other non-regulated affiliates. The Staff and SWDE agreed to resolve and settle Phase II by a settlement agreement executed on August 29, 2017 (the “Settlement Agreement”).¹

Although the Hearing Examiner has found that the Settlement Agreement is in the public interest and recommends that the Commission approve it, the Hearing Examiner goes on to make recommendations which, if adopted by the Commission, would directly conflict with the terms agreed to by the parties in the Settlement Agreement. Specifically, the Hearing Examiner recommends the Commission declare that any change to cost allocation methodology by any Delaware public utility be subject to prior Commission review and approval.

In contrast, the parties’ negotiated compromise involves only SWDE and does not require pre-approval. Rather, the Settlement Agreement calls for SWDE to make an informational filing before implementing future changes to the cost allocation methodology under its current Management and Services Agreement and affords the Staff and Public Advocate a thirty day period to decide whether to seek Commission review of the proposed change. (Agreement ¶ 17). Absent challenge, SWDE would implement modification of the cost allocation methodology.

¹ The Public Advocate is not a signatory to the Settlement Agreement, but does not oppose it.

Whether challenged or not, SWDE's implementation of the changed methodology would have no effect on SWDE's rates billed to customers unless and until SWDE's next rate case filing seeking to change its rates billed to customers pursuant to 26 Del. C. § 304.

By establishing a pre-approval requirement *sua sponte* the Hearing Examiner undoes the compromise negotiated between the parties. The provisions of the Settlement Agreement are not severable. The Commission should not jeopardize an agreement found to have been in the public interest and should not thereby send the parties back to litigate Phase II. Pre-approval is not part of the Settlement Agreement. Moreover, accepting the recommended pre-approval requirement would not satisfy procedural fairness requirements. Additionally, the recommendation purports to apply to other Delaware utilities who were not made parties to Phase II and had no opportunity to be heard on this issue.

To be clear, SWDE does not dispute the Commission's power to impose a pre-approval requirement for Delaware utilities by rulemaking or by seeking a statutory amendment. But no statute or regulation currently imposes such a requirement. SWDE respectfully urges the Commission to reject the means recommended here, which undoes the Settlement Agreement and does not afford SWDE and other utilities an opportunity to be heard in opposition or to help craft an appropriate pre-approval regulation through a proper rulemaking proceeding.

BACKGROUND

SWDE is a wholly owned subsidiary of SUEZ Water Resources Inc. ("Resources"). (Report ¶ 2). Resources also owns several other regulated water utilities. *Id.* Resources is owned by SUEZ Water, Inc. SUEZ Water Inc. also owns SUEZ Water Management and Services Inc. ("M&S"). *Id.* M&S provides shared services to SUEZ Water's business units including SWDE, other regulated water companies owned by Resources and other non-regulated affiliates. *Id.*

M&S's shared services include administrative, engineering, legal, accounting, finance, human resources, purchasing, insurance, data processing, customer service, customer billing, public relations, planning and ratemaking services. (Report ¶ 10).

As SUEZ's operations evolved over time, the prior allocation methodology used by SUEZ's predecessors (General Waterworks and United Water) became out-dated. (Report ¶ 31). The old cost allocation factors applied too much expense to the regulated SUEZ utility operations and not enough to unregulated operations, potentially causing ratepayers to bear disproportionately greater expense. *Id.* Based on recommendations in a consulting report and to coordinate its new cost allocation methodology ("CAM") with the introduction of new accounting software, SUEZ implemented the new CAM in October 2015. *Id.* at ¶ 32. It employs a three factor general allocator methodology commonly used by utilities throughout the United States including Delaware. Introducing the new CAM in conjunction with the organization's new accounting software permitted SUEZ to avoid a subsequent, expensive modification of the software. *Id.* SWDE did not seek Commission approval at that time because it was not then seeking to change its rates billed to customers, and no statute or regulation required approval absent a rate change.

SWDE filed a new rate case in February 2016. (Report ¶ 1). In its filing it included testimony explaining the change in the CAM and the reasons behind it. SWDE sought Commission approval of the new CAM in its rate application. It provided exhibits and discovery explaining that the new CAM produced rate savings of over \$236,000 annually compared to the old CAM. (Report ¶¶ 17, 37.) SWDE also met with Staff and DPA to explain the changes. During the rate case, SWDE updated its application to report that other jurisdictions, including New York, Pennsylvania, and New Jersey had approved the new CAM. (Report ¶ 47).

After analyzing the data provided by SWDE, the DPA elected not to oppose the CAM and its corresponding rate savings. (Report n.2). Staff, however, continued to question the new CAM and insisted that SWDE prepare new exhibits in support of its rate application using the old CAM. SWDE complied with Staff's request. Staff then requested that review of the new CAM be deferred to Phase II.

Eventually, the parties settled Phase I, incorporating the savings from the new CAM and agreeing that the newly settled rates billed to customers would not be affected or diminished as a result of the Phase II proceeding, regardless of its outcome and whatever CAM emerged from such proceedings. (Order 9027, Exhibit 1 ¶ 17).

THE PHASE II SETTLEMENT

After the Commission entered Order No. 9027 on February 23, 2017, approving settlement of SWDE's rate application, the parties engaged in further discovery in Phase II regarding the new CAM. Staff and SWDE filed additional testimony on the subject. Eventually, the parties renewed settlement negotiations. Staff advocated a pre-approval process requiring Commission approval of any proposed change in the CAM, irrespective of whether SWDE was seeking any change in its rates billed to customers. SWDE objected to this proposal explaining its unwillingness to accept by agreement a requirement not applicable by statute or regulation to it or any other Delaware utilities. Eventually, the parties compromised this issue with paragraphs 17 and 18 of the Settlement Agreement with both signatories agreeing that the compromise is in the public interest. The agreement calls for an informational filing by SWDE concerning proposed CAM changes and an opportunity for Staff or DPA to challenge the change before the Commission, providing in pertinent part as follows:

17. The Company further agrees that changes to the allocation methodology used in the new M&S Agreement shall be communicated through an informational

filing to Staff and the Public Advocate at least 30 days prior to implementation, whereby either Staff or Public Advocate may request Commission review at their option.

18. The Company also agrees to communicate through an informational filing and if requested meet with Staff and the Public Advocate to communicate significant accounting or software changes as they relate to the new M&S agreement at least 30 days prior to implementation, whereby either Staff or Public Advocate may request Commission review at their option. (Settlement ¶¶ 17-18).

Of course, SWDE in connection with any future rate case application to change its rates billed to customers will continue to bear the burden of establishing the justness and reasonableness of any rate change resulting from modifications to the CAM.

Other salient features of the Settlement include the following:

- i. SWDE agreed to guarantee savings of \$236,000 in the next case if the new M&S methodology (compared to the old methodology) does not yield such savings. (Agreement, ¶¶ 14-16);
- ii. The parties agreed to support the Settlement Agreement and work expeditiously and in good faith to obtain its approval. (Agreement, ¶ 20);
- iii. The parties agreed that the provisions of the Settlement are not severable, and it is not binding unless the Commission approves it in its entirety. (Agreement, ¶ 20);

ARGUMENT

- A. The Commission Should Approve the Settlement Agreement Made by the Parties Because it is a Compromise in the Public Interest

The Public Utilities Act encourages settlements where the Commission finds them to be in the public interest. 26 Del. C. § 512. The Hearing Examiner recommends approval of the Phase II Settlement Agreement because it is just, reasonable and in the public interest. (Report,

¶ 51). Commission approval of the Settlement Agreement, however, requires the Commission to reject the Hearing Examiner's additional recommendation that the Commission also impose a pre-approval requirement that would undo the parties' compromise.

There can be no question that the Hearing Examiner's recommendations in paragraph 52 of his report and paragraph 4 of his proposed order directly conflict with paragraphs 17 and 18 of the parties' settlement agreement. While the parties agreed to only an informational filing, the Hearing Examiner would have the Commission require SWDE to apply for and obtain Commission approval before making any change to its CAM. It would require this pre-approval any time that SWDE decides to modify its CAM and irrespective of whether SWDE is seeking to change its rates billed to customers. This is the very requirement that SWDE objected to and that the parties agreed to avoid in their Settlement Agreement.

Thus, this additional recommendation of the Hearing Examiner, outside of the terms of the Settlement Agreement, conflicts with the agreement and undoes the parties' compromise. Because the Settlement Agreement is not severable and because it is not binding unless adopted in its entirety,² this additional recommendation would undo the very settlement the Hearing Examiner has recommended the Commission adopt.

The Hearing Examiner's purported justification for imposing this pre-approval requirement is misguided. The Hearing Examiner relies on 26 *Del. C.* §§ 201(a) and 304(a) that give the Commission general jurisdiction over public utilities and their rates billed to customers, and prohibit a utility from making any change in an existing rate billed to customers without 60 days notice to the Commission. Neither statutory provision, however, requires Commission pre-approval of CAM modifications or other accounting changes when the utility seeks no

² See Settlement Agreement, Article III, ¶ 20.

corresponding change in its rates billed to customers. In the broadest sense, the Hearing Examiner's contextual reliance on 26 *Del. C.* §§ 201(a) and 304(a) means that any and all changes to the Company's books and records, even through normal day-to-day transactions, would require 60 days notice to the Commission as each transaction could at some future date impact rates billed to customers in a subsequent rate case application. For example, a Mains project increasing rate base or a change in Generally Accepted Accounting Principles affecting the utility's accounting apparently would require pre-approval under this premise because the cost would be included in the next base rate case filing.

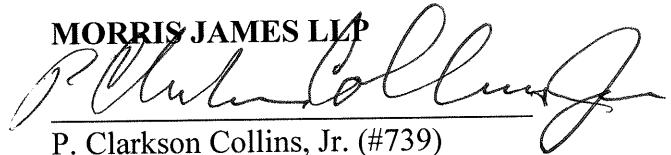
If the Commission wants to impose a pre-approval requirement for the future, it can seek legislation requiring it or initiate a rulemaking proceeding in accordance with the Administrative Procedures Act, with notice to Delaware utilities and an opportunity for them to be heard on the scope and terms of such a regulation. 29 *Del C.* §§ 10101 *et. seq.* There is no need to upset a settlement that is undisputedly in the public interest and that does not otherwise limit the Commission's future ability to review accounting changes in connection with SWDE rate change applications.

CONCLUSION

For the reasons stated herein, SWDE respectfully requests that the Commission approve the Settlement Agreement and decline to adopt the Hearing Examiner's recommended pre-approval add-on, which is outside of, and conflicts with the terms of the parties' settlement.

Respectfully submitted,

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Counsel for SUEZ Water Delaware, Inc.

Dated: October 18, 2017

EXHIBIT A

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

| | | |
|-------------------------------------|---|------------------------|
| IN THE MATTER OF THE APPLICATION OF |) | |
| SUEZ WATER DELAWARE, INC. FOR A |) | PSC DOCKET NO. 16-0163 |
| GENERAL INCREASE IN RATES |) | (Phase II) |
| (FILED FEBRUARY 5, 2016) |) | |

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

DATED: September 26, 2017

R. Campbell Hay
HEARING EXAMINER

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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF)
SUEZ WATER DELAWARE, INC. FOR A) PSC DOCKET NO. 16-0163
GENERAL INCREASE IN RATES) (Phase II)
(FILED FEBRUARY 5, 2016))

R. Campbell Hay, duly-appointed Hearing Examiner in this Docket pursuant to 26 Del. C. §502 and 29 Del. C. ch. 101 and by Commission Order No. 8861 dated March 22, 2016, reports to the Commission as follows:

I. APPEARANCES

On behalf of the Applicant, Suez Water Delaware, Inc.
("Suez Delaware") or ("the Company"):

MORRIS, JAMES, HITCHENS & WILLIAMS, LLP
By: P. CLARKSON COLLINS, JR, ESQ.

On behalf of the Public Service Commission Staff ("Staff"):

ASHBY & GEDDES, P.A.
By: JAMES GEDDES, ESQ., RATE COUNSEL

On behalf of the Division of the Public Advocate
("DPA"):

By: REGINA A. IORII, ESQ., DEPUTY ATTORNEY GENERAL

II. BACKGROUND

1. On February 5, 2016, Suez Water Delaware, Inc. filed an Application requesting an increase in its general water rates.¹ (Exh. 1, p.1)

¹ The evidentiary hearing exhibits will be cited herein as "Exh.__." References to the pages of the evidentiary hearing transcript will be cited as "Tr.-__." Schedules from the Company's Application or pre-filed testimony will be referred to as "Sch.__."

2. Suez Water Delaware Inc. is wholly-owned by Suez Water Resources Inc. ("Resources"). Resources also owns several other regulated water utilities located and operating in New York, New Jersey, Pennsylvania and elsewhere. Resources, in turn, is wholly-owned by Suez Water Inc., which also owns a company named Suez Water Management & Services Inc. ("Suez M&S"). Suez M&S provides a host of 'shared' services to Suez Water Inc.'s business units, including Suez Delaware, other regulated water utility companies owned by Resources, and other non-regulated affiliates." (Exh. 8 at p.2)

3. Suez Delaware's Application included adjustments to its Cost of Service based upon a recently revised Management & Services Agreement ("Revised M&S Agreement"), which changed the basis for allocating the management and service expenses that Suez M&S provides among the Suez companies, including Suez Delaware. Staff objected to the new cost allocations because the allocations had not previously been approved by the Commission. The Company disagreed and asserted that no pre-approval of the allocations before the rate case was required. Staff further objected to the use of the revised allocations and the approval of rates based on the M&S allocations in the rate case.

4. On March 11, 2016, the DPA filed its Statutory Notice of Intervention pursuant to 29 Del. C. §8716(h).

5. With Commission approval, the parties agreed to defer consideration of the Revised M&S Agreement until Phase II of this proceeding, commencing after the Commission determined the merits of Suez' Rate Application in Phase I.

6. On January 17, 2017, the parties executed a proposed Settlement Agreement as to Phase I of this Docket. On February 23, 2017, by PSC Order No. 9027, the Commission approved the parties' Settlement Agreement, the deferral of the Cost Allocation Methodology issue to Phase II, and the revised water rates, rate structure and tariffs described therein, resolving Phase I of this Docket.

7. On June 29, 2017, after public notice, I commenced an evidentiary hearing in Wilmington, Delaware as to Phase II of this Docket. At Staff's and the Company's request, I continued the hearing to allow them to conduct further settlement negotiations. The parties stipulated to the admission of twenty (20) exhibits and I admitted them into evidence, including the exhibits entered in Phase I.

8. On August 29, 2017, Staff and the Company presented me with an executed Settlement Agreement as to Phase II of this Docket.²

9. On August 29, 2017, after public notice, I resumed the evidentiary hearing as to Phase II of this Docket. Two (2) additional exhibits were admitted into evidence, making a total of twenty-two (22) exhibits in Phase II. At the hearing, one witness testified on behalf of the Company and one witness testified on behalf of Staff. The DPA called no witnesses and did not cross-examine the other parties' witnesses. At the conclusion of the hearing, I closed the evidentiary record. This Report addresses only Phase II of this Docket.

² The DPA was not a signatory to the Settlement Agreement, but represented at the continued evidentiary hearing that it did not oppose the Settlement Agreement. (Tr., pp.116-17)

III. PRE-FILED DIRECT TESTIMONY

A. Company's Pre-filed Testimony - Prettyman

10. In Phase I of this Docket, Gary S. Prettyman, Suez' Senior Director of Regulatory Business, testified in support of Suez' Revised Management and Services fees and the new methodology used to allocate those fees³ among Suez Delaware and Suez's other companies. According to Mr. Prettyman, M&S provides certain services such as "administration, communication, customer service, finance, human resources, information systems, legal, procurement, technical services, and other general services necessary to conduct business." (Exh. 4 at p.2)

11. According to Mr. Prettyman, the original contract was executed in 1974 and was amended in 1995 when General Water Works merged with United Water. Subsequently, Suez acquired United Water. (*Id.*)

12. Mr. Prettyman explained that, under the original contract, labor charges were either "charged directly to a project or [Suez-related] company or allocated based upon certain formulas." According to Mr. Prettyman, the formulas contain many factors, which makes analysis difficult. (*Id.*)

13. Mr. Prettyman testified that "[t]he goal of the [Revised M&S Agreement] is to make cost allocations simpler and more transparent." According to Mr. Prettyman, the new formula is based upon a three factor formula. The factors in the formula are revenue, assets, and

³ The Management and Services fees were briefly discussed in Phase I. The allocation of the fees will be discussed in this Phase II of this Docket, as agreed to by all parties and approved by the Commission.

payroll. Mr. Prettyman added, "[a]ll employee time will be based on this formula and therefore allocated appropriately. The exception to this would be engineers and IT personnel who typically work specifically on a certain project." (*Id.* at p.3)

14. According to Mr. Prettyman, the first step of cost allocation under the Revised M&S Agreement regards each department's function. "For example, if a department works solely for regulated companies like Suez Delaware, then 100% of that department's time and expenses" is allocated to the regulated company. Likewise, "if a department works 100% for a non-regulated business, then 100% of that department's time and expenses" is allocated entirely to the non-regulated company. Each department which works for the benefit of all businesses is allocated according to the three (3) factor formula. (*Id.*)

15. Mr. Prettyman testified that, under the original contract many expenses paid by M&S are either allocated or charged directly based upon certain formulas and are included in M&S Fees. These expenses include, for example, general liability and properly insurance, outside IT support, audit fees and actuarial fees. Under the new allocation method, these expenses will be included in M&S fees. (*Id.* at pp.3-4)

16. According to Mr. Prettyman, although the original M&S agreement did not address allocation of capital additions, in practice capital expenditures, "generally related to IT issues,"⁴ were "allocated to each operating company and reflected on that company's

⁴ These issues include the PeopleSoft accounting software upgrade and the Powerplan asset management software.

balance sheet." He stated that this treatment increases the operating company's rate base and is recovered in rates through depreciation expense and rate of return. Mr. Prettyman testified that under the Revised M&S Agreement, "assets [will] be maintained on [the] M&S balance sheet and allocated to the operating companies and recovered through deprecation and return." Mr. Prettyman explained that, "[a]s a result, the revenue requirement is the same for these assets under the new method or the old method." (*Id.* at p.4)

17. Finally, Mr. Prettyman testified that if the proposed allocation methodology was applied to the rate case in Phase I, Suez Delaware's ratepayers would have saved \$236,082. (*Id.*)

B. Staff's Pre-filed Testimony - Woodward

18. Ms. Amy Woodward, Staff Analyst, testified that Suez' current Commission-approved M&S Agreement includes a number of allocation factors to distribute common expenses among regulated and non-regulated participants to the contract, "based on cost causation." According to Ms. Woodward, the costs are classified on a "direct basis for each asset, service, or product provided" and costs that provide service to a particular affiliate or division are captured and attributed to that specific affiliate or division. Ms. Woodward further testified that some costs are common to "all affiliates or divisions and are allocated among all affiliates and divisions on a fully-allocated basis using various allocators which are intended to reflect cost-causation." (Exh. 2, p.3)

19. Ms. Woodward testified that, under the Revised M&S Agreement, unilaterally adopted without prior Commission approval,⁵ the prior multiple allocator approach would change to a three-factor formula for all categories of costs which are not directly charged. She stated that the proposed methodology would "be based on the simple, unweighted average of each participant's relative gross revenue, total assets, and payroll costs." (*Id.* at p.3)

20. In her pre-filed testimony, Ms. Woodward stated that she does not agree with Suez Delaware's proposed changes to the M & S Agreement, explaining that the new Revised M&S Agreement, "in the way it displaces allocation based on cost-causative allocation factors, is not in the best interest of Delaware rate payers." Ms. Woodward also testified as to her disagreement with two of the three (3) factors in the new Revised M&S Agreement. First, she testified that she disagrees with the total asset factor in the new agreement, stating that it favors the unregulated business units because their actual expenses flow directly to their earnings. Ms. Woodward explained that, "the result is the regulated business units are punished for being able to recover the underlying costs" and "[t]otal assets would increase the risk of Delaware ratepayers subsidizing non-utility unregulated business units."

21. Ms. Woodward testified that if, in the future there are more unregulated business units, the cost shift could impact Delaware ratepayers in that regulated business units would then be subsidizing

⁵ If the Commission approves the Settlement Agreement, it will approve the Revised M&S Agreement dated July 21, 2016, "seven (7) months after the allocation method was changed in the Company's accounting system, without Commission approval." (Exh.4 at p.2)

the unregulated business units because with a regulated utility expenses are absorbed by the ratepayers rather than passed down to earnings as in unregulated businesses. In her estimation, Ms. Woodward believes that Net Plant (plant, property and equipment) is a better measure of each business unit's investment, stating "[i]t provides a better measurement of each of the business unit's capital investment by recognizing depreciation expenses." (*Id.* at p.4)

22. Ms. Woodward testified that instead of using total payroll costs in the three-factor formula, only O&M labor expenses should be used to determine shared costs. She explained that "[t]otal payroll costs would count capitalized labor twice, once in the payroll costs and again in total assets because capitalized labor becomes part of plant in service or total assets... ; therefore, it would be used twice in allocation using the three factor method" Suez Delaware proposes. (*Id.* at p.5)

23. Ms. Woodward testified that, "[i]t is common practice among the utilities in Delaware to collect all costs at each level and bill them on a direct basis for each asset, service or product provided." She further testified that, "[i]t is also common practice to be able to properly audit and trace on the books of the regulated utility all direct and allocated costs between regulated and non-regulated services and products." Ms. Woodward stated that, "[i]ndirect costs are normally billed on a fully allocated costs basis among affiliates" and that Delaware utilities generally "classify costs of services or products as regulated or non-regulated or, perhaps, a common to both." Ms. Woodward noted that, "other Delaware utilities use sets of cost drivers

to allocate shared services costs, similar to the approach that [Suez Delaware] now wants to abandon." (*Id.*)

24. According to Ms. Woodward, Delmarva Power, Tidewater Utilities, Chesapeake Utilities Corporation, and Artesian Water Company use similar methods for their regulated utilities. She noted that those companies' costs are typically assigned directly, if possible. Ms. Woodward further testified that if direct assignment is not possible the utility will apply cost drivers to fairly allocate expenses.⁶ (*Id.* at p.6)

25. Ms. Woodward testified that the ratemaking and cost allocation concept behind the way the other Delaware utilities operate within their affiliate service company agreements is to use cost-causative drivers to allocate expenses, which "reflect the way that costs are incurred to the maximum extent possible." (*Id.* at pp.6-7)

C. Staff's Pre-filed Testimony - Peterson

26. Staff Consultant David Peterson began by describing the prior M&S Agreement. (Exh. 8) According to Mr. Peterson, the way the Company interpreted the prior M&S Agreement "resulted in three (3) broad categories of costs that were billed to the Company: 1) costs that were directly charged to Suez; 2) shared costs which were allocated to Suez; and 3) Corporate Assumptions charges, which were also shared costs but were not accounted for as an M&S charge." Mr. Peterson testified that the specific accounts in Corporate Assumptions charges relate to expenses such as billing and advertising. Mr. Peterson stated, however, that rather than being outside activities

⁶ See Table AJW-1, attached to Exh. 2.

these are shared services and had their own allocation factor. (*Id.* at p.5)

27. Mr. Peterson discussed how charges are defined under the revised M&S Agreement. "Direct Charges" are those for which work is related to a specific project, such as Engineering and Information Technology department expenses. "Segment Specific Allocations" are shared service functions which are aligned with the affiliates for which the services were performed, to the extent practicable. Mr. Peterson stated, "[f]or functions supporting the regulated utility business segment, costs are allocated to the individual regulated utility affiliates using the three-factor formula described below." "Services Benefiting All Affiliates" means allocated costs are based on the three (3) factor formula. (*Id.* at p.6)

28. Mr. Peterson testified that in most companies a "significant majority" of costs are assigned directly to the affiliate for which the service was provided. He stated that in his review of other mutual service company agreements as much as 70 percent of costs were directly charged to the entity for which the service was provided. Suez, however, directly charges less than one percent (.44%) of M&S's fees in 2014.⁷ (*Id.* at p.9)

D. Company's Response to Staff's Pre-filed Testimony (Phase II)

- Prettyman

29. Mr. Prettyman filed rebuttal testimony in Phase II. In his rebuttal, Mr. Prettyman responded to Staff's Phase II testimony, specifically Ms. Woodward's and Mr. Peterson's testimonies, reiterating

⁷ 2014 was the first year for which data was provided. (Exh. 8, p.9)

what Mr. Prettyman had testified to in Phase I regarding Cost Allocation. (Exh. 11)

30. Mr. Prettyman testified that after reviewing the pre-filed, Phase II testimonies of Ms. Woodward and Mr. Peterson, it seemed "clear" that no analysis or calculations were performed. Mr. Prettyman testified that, "... their overwhelming argument is that the M&S agreement is different than other Delaware utilities and therefore is not acceptable." (*Id.* at p.15)

31. Mr. Prettyman stated that when the first agreement was put into place in 1974, the predecessor company, General Waterworks, owned mostly regulated water companies. He testified that under that structure, the prior M&S Agreement and the allocation factors therein made sense. Mr. Prettyman then testified that after subsequent acquisitions, the number of non-regulated businesses has "grown considerably." He explained that, "[b]ecause of some of the allocation factors from the old agreement, such as customers and utility plant, more of the M&S costs were being allocated to the regulated companies than the non-regulated companies because the non-regulated companies did not have any customers or utility plant. (*Id.* at pp.15-16)

32. In addition, Mr. Prettyman testified that the secondary reason for the change was that Suez implemented a new accounting system in October 2015, and it was more cost effective to introduce the new Cost Allocation Methodology as the accounting system was upgraded. (*Id.* at p.16)

33. Mr. Prettyman also stated that, "... if Delaware had different allocation factors from the other affiliates there could be allocated

either more or less costs than utilizing the consistent allocation factor which could cause M&S to allocate more than 100% of its costs."⁸ (*Id.* at pp.16-17)

34. As to Mr. Peterson's testimony that 70% of service company costs should be direct charged, Mr. Prettyman testified that Staff provided no analysis and that Mr. Peterson's conclusion was "based upon a conversation with someone from the SEC in 2002 when he began looking at service company charges."⁹ (*Id.* at p.19)

IV. EVIDENTIARY HEARING

35. On the first day of the evidentiary hearing, June 29, 2017, Suez' attorney, P. Clarkson Collins, Jr., stated the following during his opening statement regarding the revised M&S Agreement:

"It is important to note that the allocation of costs that we're talking about applies to allocable common costs and does not address direct charges. As a matter of course, direct charges are not allocated.

The cost allocation methodology under review already has been specifically approved in two jurisdictions, that is Pennsylvania and New Jersey. And, as noted in the testimony in its last rate case is being utilized for accounting purposes in New York.

It has also been implemented in two other jurisdictions, Rhode Island and Idaho.

Of course, we recognize that the allocation methodology is primarily for accounting purposes.

We understand that accounting treatment and rate-making treatment can and sometimes do differ.

⁸ As an example, Mr. Prettyman referred to Ms. Woodward's testimony that using net plant as a factor would be "a better measure of each business unit's investment." Mr. Prettyman said that using net plant, as Ms. Woodward suggested, would attribute 5.5% of the total to Delaware. He suggested that using total assets, under the new Agreement would attribute 4.7% of the total to Delaware. He stated that under the net plant, all else being equal, the amount allocated would be 100.7%. (*Exh. 11, p.17*)

⁹ In which the SEC uses a 70/30 rule. (*Id.* at p.19)

Rate-making has already been determined in this proceeding in Phase I.

This portion of the case relates to the continued use of the new M&S Agreement and CAM¹⁰ for accounting purposes." (Tr., p.92 at LL 6-24; p.93 at LL 1-6)

36. The evidentiary hearing for this docket concluded on August 29, 2017. At the hearing, Staff and the Company presented me with a duly-executed proposed Settlement Agreement. The Company presented Mr. Prettyman and Staff presented Ms. Woodward to testify regarding the proposed Settlement Agreement.

37. Mr. Prettyman testified that he believes the Settlement Agreement is in the public interest because it would save additional rate case litigation expenses, the cost allocation methodology will now be uniform across all Suez' entities, will save Delaware ratepayers the programming expense to develop new technology, and ensures \$236,000 savings in the next rate case. (Tr. at pp.106-107)

38. Ms. Woodward testified that she believes the Settlement Agreement is in the public interest because it results in \$236,000 savings to Delaware ratepayers. Furthermore, any changes in accounting or cost allocation methodologies must be communicated to Staff and the DPA at least thirty (30) days prior to implementation of such changes, and Suez agrees to meet with Staff and the DPA to discuss ring fencing¹¹ issues. (Tr. at p.111-112)

39. I questioned Ms. Woodward on the thirty (30) day notification provision to which Mr. Geddes replied on behalf of Staff that "if there can't be a resolution within the 30 days, then the

¹⁰ CAM stands for Cost Allocation Manual.

¹¹ Ring fencing is a term used when a regulated utility financially separates itself from a parent company that engages in unregulated business.

Commission would have to act." (Tr. at p.115)

V. THE PROPOSED SETTLEMENT AGREEMENT

40. On August 29, 2017, Staff and the Company presented me with an executed proposed Settlement Agreement ("Settlement"). At the evidentiary hearing, I admitted the Settlement into the record. (Tr., p.104) The Settlement is attached as Exhibit "A" hereto. Staff and the Company's witnesses testified that the Settlement was just and in the public interest.

41. Although Staff does not agree with Suez Delaware's proposed Cost Allocation methodology, it did recognize that because the proposed methodology has already been implemented, it would cost Delaware ratepayers more to change it. Therefore, in the Settlement, Staff agreed not to oppose the change in methodology in exchange for a commitment that future cost savings for ratepayers are guaranteed in the next rate case. (Exh. 22, p.4, section 15)

42. The Settlement provides the following:

- 1) Staff agreed to accept the proposed cost allocation methodology in return for assurances from the Company that the \$236,000 savings realized under the new methodology is guaranteed;¹²
- 2) The Company will provide Staff with a comparison of savings to ratepayers between the old and new cost allocation methodologies in its next rate case;
- 3) The Company will provide at least 30 days' notice

¹² The Settlement provides that if the new methodology does not produce savings of at least \$236,000, the Company will adjust future revenue requirements in the next rate case to provide that level of savings to ratepayers. (Exh. 22, pp.4-5, section 15)

- to Staff and the DPA before any changes in cost allocation methodology and other significant accounting or software changes as they relate to the M&S Agreement, during which time Staff and the DPA may recommend Commission review and approval before such changes can be implemented; and
- 4) The Company agrees to meet with Staff and the DPA to discuss potential ring fencing issues.
- (*Id.* at pp.4-5)

VI. DISCUSSION

43. I hereby incorporate Sections II through V as my Findings of Fact.

44. Suez Delaware and Staff representing diverse interests, agree that the Settlement is just and reasonable and is in the public interest. The Company and Staff have testified, that the Settlement was reached after significant discovery and negotiations between Staff and the Company in Phase II of this Docket. I find their testimony persuasive. For the reasons that follow, I recommend that the Commission approve the Settlement.

45. 29 *Del. C.* §10125(c) places the burden of proof upon the applicant, Suez Delaware.

46. 26 *Del. C.* §512(a) provides that "[i]nsofar as practicable, the Commission shall encourage the resolution of matters brought before it through the use of stipulations and settlements." 26 *Del. C.* §512(c) provides that the Commission may approve a settlement if it is

in the public interest.

47. There is substantial evidence in the record in this case to support my recommendation that the Settlement be approved.¹³ (29 Del. C. §10142(d)) First, the Settlement was the product of extensive negotiation and compromise between Staff and the Company. The record evidence supported already that the agreed-upon cost allocation approach is approved, implemented or utilized in five (5) jurisdictions in which Suez regulated utilities operate. This supports implementing it in Delaware, as well.

48. Next, if the agreed-upon Cost Allocation approach was applied to the rate case in Phase I, Suez Delaware's ratepayers would have saved \$236,082. (Exh. 4, p.2)

VII. FINDINGS AND RECOMMENDATIONS

49. Pursuant to the Commission's instructions, I hereby submit for consideration these proposed Findings and Recommendations.

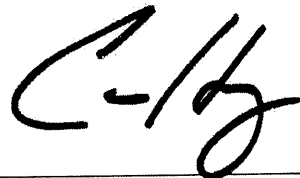
50. The Commission has jurisdiction in this matter pursuant to 26 Del. C. §201(a).

51. For the reasons stated above, I find that the proposed Settlement Agreement is in the public interest. Accordingly, I recommend that the Commission adopt this Report and approve the proposed Settlement Agreement. A proposed Order implementing the foregoing recommendations is attached hereto as Exhibit "B" for the Commission's consideration.

¹³ Substantial evidence has been defined to mean, "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." Substantial evidence is "more than a scintilla, but less than a preponderance..." *Olney v. Cooch*, 425 A.2d 610, 614 (Del. 1981); *Price v. State of Delaware Board of Trustees*, 2010 WL 1223792 (Del. Super. Mar. 22, 2010) (unpublished opinion).

52. Although I recommend approval of the proposed Settlement along with its Cost Allocation approach, which was implemented by Suez Delaware without prior Commission approval, any future change to Cost Allocation Methodology will be subject to Commission review and approval. 26 Del. C. §201(a) grants the Commission "exclusive original supervision and regulation of all public utilities and also over their rates" Furthermore, 26 Del. C. §304(a) states that "[u]nless the Commission otherwise orders, no public utility shall make any change in any existing rate except after 60 days notice to the Commission" Therefore, a Delaware public utility amending its Management & Services Agreement affecting the method of Cost Allocation to the utility's Delaware ratepayers should be required to provide notice of and receive Commission approval to protect the interests of Delaware ratepayers. In this case, it is evident that a change in Cost Allocation Methodology can affect rates, as the savings of \$236,082 indicates. However, under §304(a) the Commission may order otherwise. As such, in the absence of a Commission order stating other requirements, any change to Cost Allocation methodology by a Delaware public utility is subject to Commission review and approval.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'C-Hay', written over a horizontal line.

R. Campbell Hay
Hearing Examiner

Exhibit "A"

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE**

IN THE MATTER OF THE APPLICATION)
OF SUEZ WATER DELAWARE INC. FOR A)
GENERAL INCREASE IN RATES AND FOR) PSC DOCKET NO. 16-0163
REVISIONS TO ITS TARIFF (FILED)
FEBRUARY 5, 2016) (PHASE II))

SETTLEMENT AGREEMENT

This Settlement Agreement (the "Settlement Agreement") is entered into by and between SUEZ Water Delaware Inc. ("SWDE" or "the Company"), and the Staff of the Public Service Commission ("Staff") (collectively, "the Settling Parties").

I. INTRODUCTION AND PROCEDURAL BACKGROUND

1. On February 5, 2016, SWDE filed an application with the Delaware Public Service Commission ("the Commission"), pursuant to 26 *Del. C.* §§ 306, for approval of (1) a base rate increase designed to produce \$4,943,665¹ in additional annual revenues (an approximate 19.96% increase over SWDE's current overall revenues) (the "Application"), and (2) various changes to its water tariff as described in its Application.

2. The Company's Application included a request pursuant to 26 *Del. C.* §306(c) to place into effect on April 5, 2016, subject to refund, rates that would collect additional annual revenue of approximately \$2,499,338 (which, would represent an increase of approximately 10% over existing base rate revenues), an amount which did not exceed 15% of SWDE's annual gross intrastate operating revenues.

¹ This proposed increase included \$1,696,286 of existing Distribution System Improvement Charge ("DSIC") surcharges that are being rolled into base rates in this proceeding, after which the DSIC will be reset to zero.

3. On March 11, 2016, the Public Advocate filed an amended Statutory Notice of Intervention pursuant to 29 *Del. C.* § 8716.

4. On March 22, 2016, the Commission entered PSC Order No. 8861, suspending the effect of the proposed new rates pending investigation and a hearing, appointing R. Campbell Hay Hearing Examiner, and allowing SWDE to collect the requested interim rates, subject to refund as permitted by 26 *Del. C.* §306(c).

5. On August 19, 2016, SWDE submitted a Petition with proposed tariff sheets seeking to implement a revised interim rate increase of \$3,944,930 as permitted by 26 *Del. C.* § 306(b), effective September 5, 2016. Because this increase was cumulative to the increase put into effect April 5, 2016, this interim increase added \$1,445,592 to the interim rates then in effect.

6. By Order No. 8935 dated August 23, 2016, the Commission approved the requested additional interim rate increase. Thereafter, Staff and the Public Advocate filed testimony on the proposed revenue requirement increase. A settlement agreement with respect to the revenue requirement was entered into between the parties on January 17, 2017, which the Commission approved by Order No. 9027, dated February 23, 2017.

7. Included in SWDE's initial Application were proposed adjustments to its cost of service based upon a recently revised Management & Services Agreement ("M&S agreement") revising the basis for allocating M&S expenses among the regulated and non-regulated subsidiaries of SUEZ, including SWDE. Staff objected to the new cost allocations because the Commission had not previously approved them and Staff further objected to the use of revised allocations and the approval of rates based on the M&S allocations in this rate proceeding.

8. With the approval of Hearing Examiner Hay, the parties agreed to defer consideration of the M&S Agreement until Phase II of this proceeding, commencing after the Commission determined SWDE's Application in Phase I. The parties and the Hearing Examiner established a procedural schedule for Phase II. The Commission confirmed the Hearing Examiner's continuing authority to conduct Phase II proceedings in its Order No. 9027

9. Pursuant to the Phase II schedule, Staff filed testimony on May 4, 2017 recommending that the Commission reject the M&S Agreement as drafted and order the Company to draft a new M&S Agreement addressing some of the weaknesses in the old M&S Agreement, as well as some of the allocation concerns raised by Staff in its testimony.

10. On June 1, 2017, the Company filed responsive testimony supporting the M&S Agreement as drafted and taking exception with Staff's conclusions and recommendations regarding allocation of some of the indirect costs using a three-factor allocation methodology.²

11. On June 29, 2017, the Hearing Examiner held an evidentiary hearing at which time Staff and the Company asked for a recess to discuss possible resolution of the outstanding issues. At the conclusion of those discussions, Staff asked that the hearing be adjourned for the purpose of submitting a settlement proposal to the Company in an attempt to resolve the issues in a way that might further benefit ratepayers.³

12. Subsequent to the evidentiary hearing, the Settling Parties met to discuss resolution of this proceeding.

13. It is acknowledged that the Settling Parties hold different views as to the proper resolution of many of the underlying issues raised in Phase II of this proceeding. This Settlement Agreement reflects compromises made by the Settling Parties in an effort to resolve this docket.

² The Public Advocate did not file testimony in Phase II of the proceedings.

³ The Company did not oppose Staff's adjournment request; the Public Advocate did. The Hearing Examiner granted the adjournment request.

IT IS HEREBY STIPULATED AND AGREED by SWDE and Staff that the Settling Parties will recommend to the Hearing Examiner and submit to the Commission for its approval the following terms and conditions for resolution of the pending proceeding:

II. SETTLEMENT PROVISIONS

14. The Company in its rebuttal testimony estimated that its new M&S Agreement resulted in annual savings to Delaware SWDE customers of approximately \$236,000.⁴ Staff recognizes that changing the Company's allocation methodology now, after it is in place, may result in additional costs being borne by SWDE ratepayers. Rather than press its concerns regarding the broad application of the three-factor allocation methodology in the new M&S Agreement, and relying on the Company's assurance that ratepayers in Delaware will continue to benefit under the new M&S Agreement going forward, Staff agrees to drop its opposition to the use of the cost allocation methodology if some commitment to future cost savings for customers can be guaranteed.

15. Accordingly, Staff and the Company agree that, SWDE will provide in its next rate case that it may file with the Commission a comparison of the savings to ratepayers from using the new M&S Agreement methodology versus the old M&S Agreement methodology. The comparison shall be performed in a manner similar to the one used in this proceeding to calculate the cost savings to Delaware ratepayers as described in Phase II Hearing Exhibit 11 (Mr. Prettyman's Phase II Rebuttal Testimony) page 31, and Phase II Hearing Exhibit 15, data request PSC-M&S-10.

16. If the level of cost savings resulting from using the new M&S Agreement

⁴ See Phase I Hearing Exhibit 4, Direct Testimony of Gary S. Prettyman at page 4.

allocation formula does not produce savings at a level commensurate with the estimated value established in this proceeding, the Company agrees to adjust such future revenue requirement increase request by the difference between \$236,000 and the level of savings achieved, if less than \$236,000, using the comparison methodology set forth in paragraph 15 above.

17. The Company further agrees that changes to the allocation methodology used in the new M&S Agreement shall be communicated through an informational filing to Staff and the Public Advocate at least 30 days prior to implementation, whereby either Staff or Public Advocate may request Commission review at their option.

18. The Company also agrees to communicate through an informational filing and if requested meet with Staff and the Public Advocate to communicate significant accounting or software changes as they relate to the new M&S agreement at least 30 days prior to implementation, whereby either Staff or Public Advocate may request Commission review at their option..

19. SWDE agrees to meet with Staff and the Public Advocate to discuss potential ring fencing issues.

III. MISCELLANEOUS PROVISIONS

20. This Settlement shall be subject to the approval of the Commission. The provisions of this proposed Settlement are not severable. The Settling Parties will work expeditiously and in good faith to achieve Commission approval pursuant to 26 *Del. C.* § 512. In the event the Settlement is not approved in its entirety by the Commission, then the Settlement shall be deemed an offer of compromise pursuant to Uniform Rule of Evidence 408 and no Settling Party's approval of or adoption of the Settlement shall prohibit or prejudice a Settling Party from taking any position before the Hearing Examiner and/or the Commission concerning the pending docket. The Settling Parties further agree that the Settlement is expressly conditioned upon Commission approval of the Settlement without the need for a fully litigated

evidentiary hearing and that only if the Settlement is rejected will a fully litigated evidentiary hearing on the merits be subsequently held.

21. The Settlement is the product of extensive negotiations and reflects a mutual balancing of various issues and positions. The Settlement represents a compromise for the purposes of settlement.

22. To the extent opinions or views were expressed or issues that were raised at any point in these proceedings, whether as part of a document filed or otherwise, that are not specifically addressed in the Settlement, no findings, recommendations, or positions with respect to such opinions, use or issues should implied or inferred.

23. This Settlement Agreement may be executed in counterparts, and each such counterpart shall be as valid as if all signatures appeared on the same page.

IN WITNESS WHEREOF, intending to bind themselves and their successors and assigns, the undersigned Parties have caused this Settlement Agreement to be signed by their duly authorized representatives.

Date:

8/25/2017

By:


SUEZ WATER DELAWARE INC.

Date:

8/29/2017

By:


DELAWARE PUBLIC SERVICE
COMMISSION STAFF

Exhibit "B"

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

| | |
|---------------------------------------|------------------------|
| IN THE MATTER OF THE APPLICATION OF) | |
| SUEZ WATER DELAWARE, INC. FOR A) | PSC DOCKET NO. 16-0163 |
| GENERAL INCREASE IN RATES) | (Phase II) |
| (FILED FEBRUARY 5, 2016)) | |

ORDER NO. 9117

AND NOW, this 28th day of September, 2017;

WHEREAS, the Commission having received and considered the Report and Recommendations of the Hearing Examiner ("Report") issued in the above-captioned docket, which was submitted after a duly-noticed public evidentiary hearing;

AND WHEREAS, the Hearing Examiner recommends that the proposed Settlement Agreement ("Settlement"), which is endorsed by the Company and Commission Staff, and which is attached to the Report as Exhibit "A", be adopted by the Commission;

AND WHEREAS, the Commission finds, for the reasons identified by the Hearing Examiner in his Report, that the Proposed Settlement is just and reasonable and is in the public interest as required by 26 Del. C. §512(c);

NOW, THEREFORE, IT IS ORDERED BY THE AFFIRMATIVE VOTE OF NO FEWER THAN THREE COMMISSIONERS:

1. That the Report and Recommendations of the Hearing Examiner, appended to the original hereof as Attachment "A," is hereby adopted.

2. That, consistent with the Proposed Settlement Agreement, attached hereto as Attachment "B," the Commission approves and ratifies the Cost Allocation Manual and Affiliate Service Agreement ("Agreement") involving Suez Water Management & Services, Inc. and Suez Water Delaware, Inc., a Delaware public utility. The Agreement shall be deemed effective as of January 1, 2016.

3. That the parties agree that no refunds are due to customers as a result of this Settlement.

4. That the Commission's approval and ratification of the Agreement does not authorize any Delaware public utility to amend its Management & Services Agreement affecting the method of cost allocation to the utility's Delaware ratepayers without prior Commission approval.

5. That the Commission reserves the jurisdiction and authority to enter such further Orders in this matter as may be deemed necessary and proper.

BY ORDER OF THE COMMISSION:

Chair

Commissioner

Commissioner

ATTEST:

Commissioner

Secretary

Commissioner

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE**

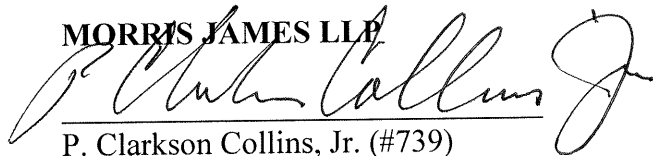
IN THE MATTER OF THE APPLICATION OF)
SUEZ WATER DELAWARE INC.)
FOR A GENERAL INCREASE IN RATES) PSC DOCKET NO. 16-0163
AND FOR A REVISION)
TO ITS GENERAL TARIFF)
(FILED FEBRUARY 5, 2016))

CERTIFICATE OF SERVICE

I hereby certify that on this 18th day of October, 2017, I caused a copy of the attached EXCEPTIONS OF SUEZ WATER DELAWARE TO THE SEPTEMBER 26, 2017 FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER AND EXHIBIT A to be served upon the following persons via electronic mail and to be filed with the Delaware Public Service Commission using the Commission's Delafile electronic filing system.

| | |
|-------------------|-----------------------------|
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Counsel for SUEZ Water Delaware, Inc.

Dated: October 18, 2017